Next 1 Page(s) In Document Exempt

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PORTUGUESE ECONOMIC SITUATION

The Portuguese economy has been shaken by political turmoil, the international recession, and increased oil prices. It will not recover until the political direction in Lisbon steadies.

Portugal has the least developed economy in Western Europe, and data on production are tardy and incomplete. We do know that strikes and other disruptions cut industrial output sharply, perhaps by 35%, in the six weeks or so following the successful coup of 25 April 1974. Much of the lost ground was quickly recovered, and for the year as a whole real gross national product probably registered a small increase. Even so, unemployment remained serious, with perhaps 200,000 people -- 7% of the labor force -- idle at year end. The problem was aggravated by the return of soldiers and civilians from the African provinces and the diminishing ability of other West European countries to absorb migrant workers.

Consumer prices rose about 25% last year despite a temporary price freeze imposed by the post-Caetano government. Wages lagged before the coup but shot up afterward, outstripping the rise in prices. The official wage index for the third quarter showed a 39% gain from the year-earlier level; we estimate a gain of 75% in the 12 largest industries.

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A host of balance-of-payments problems developed in 1974, reducing foreign reserves about $500 million to $2.4 billion at year end. The trade deficit doubled to an estimated $1.6 billion. The rise in oil costs accounted for half this increase. Net food and agricultural imports jumped by $340 million because of higher prices and increased consumption by workers benefiting from big pay boosts. A one-third increase in net earnings from the traditional exports of paper, textile, and wood products to $450 million offset only a small part of the rise in imports. Receipts from tourism and worker remittances, which had more than offset past trade deficits, declined. Political uncertainties discouraged investment by Portuguese and foreigners and caused some flight of capital.

Economic output probably has slipped somewhat in the early months of 1975. The nationalization of banks and insurance companies in the wake of the 11 March coup attempt has not yet had much direct effect on the economy. It violated the relatively moderate economic and social program announced in February, however, and in conjunction with government leaders' vows of further takeovers and the general ascendancy of the political Left, has thoroughly demoralized the business community. Scattered reports

indicate the firms generally are under extreme pressure from their employees, the government, the Armed Forced Movement, and the Communists to hike wages, avoid layoffs, and hold the line on product prices. Several prominent businessmen have been arrested. In this atmosphere, private investment probably is nil.

The tourist industry, an important source of employment as well as foreign exchange, is in a deep slump as word of political turmoil has spread abroad, reinforcing the effects of international recession and higher airline fares. Worker remittances probably are down too, partly because of economic conditions in other countries and partly because of the political situation in Portugal. Foreign reserves continue to fall.

Portugal is heavily dependent upon other West European countries and the United States for imports of manufactures -- e.g., industrial machinery, transportation equipment, iron and steel products, and chemicals. It pays for these and other imports by exporting cork and cork products, timber, paper, and wood products, resin, cotton textiles, canned fish, and wine and by obtaining foreign exchange from tourism and worker remittances. In 1974, nearly 60% of Portugal's imports came from non-communist European countries and less than 10% from the United States. Only 1.3% of imports came

from the European Communist countries and a mere 0.05% from the Soviet Union. Portugal is a member of the European Free Trade Association and has a free trade agreement with the European Community.

Portugal's needs are small -- imports from non-communist Europe and the United States totaled only $2.7 billion last year. The Soviet Union is capable of providing some of the manufactures now obtained by Portugal from these countries, but for the most part Soviet manufactured goods are below Western quality. Moreover, the Soviets have a poor record in the provision of spare parts and service for Soviet-made equipment and certainly could not provide spare parts for Western machinery. On the other hand, the Soviet Union is in an unusually good hard currency position at present and could increase Soviet purchases to benefit Portuguese export industries and the Portuguese balance of payments. Purchases of a few hundred million dollars annually would have a big impact, but Moscow may have difficulty in expanding imports to this magnitude in the short run.

Conceivably Moscow could help the tourist industry by permitting Soviet vacationers to visit Portugal. One Soviet cruise ship already has called at Lisbon, and one small group of tourists has arrived by air. Traditionally,

however, Soviet leaders have not allowed large numbers of their people to visit non-communist countries, and it is questionable whether Moscow would be willing to spend large amounts of hard currency for tourism.

So far the Soviet leaders have gone out of their way to express approval and friendship to the new Portuguese regime while being cautious and vague on the subject of aid. Although Lisbon and Moscow signed an agreement for commercial and economic cooperation at the end of last year, the only public Soviet commitments have been contracts to purchase modest quantities of wine and almonds at prices somewhat above market levels. [redacted] 25X1

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In late March, Labor Minister Costa Martins visited Moscow to ask the Soviets to buy more Portuguese products. Costa Martins was received by Premier Kosygin, who assured him that the Soviet Union would import more from Portugal -- wine and textiles supposedly were mentioned -- and pay in hard currency.

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